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In the Supreme Court of the United States

OCTOBER TERM, 1936

No. 332

FRANCIS I. DUPONT, EDMUND DUPONT, RHETT DUPONT, E. PAUL DUPONT, WILLIAM A. FINE, ARTHUR F. SHETTLE AND WILLIAM A. WHITAKER, CO-PARTNERS TRADING UNDER THE FIRM NAME AND STYLE OF FRANCIS I. DUPONT & COMPANY, PETITIONERS

v.

THE UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the District Court (R. 24–26) is not officially reported. The opinion of the Circuit Court of Appeals (R. 31–34) is reported in 83 F. (2d) 951.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 8, 1936 (R. 34). The petition

for a writ of certiorari was filed September 1, 1936, and was granted October 19, 1936 (R. 35). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether this transaction between two members of the New York Cotton Exchange constitutes a "sale, agreement of sale, or agreement to sell * * * at, or under the rules or usages of" the Exchange within the meaning of Section 800, Schedule A–4, of the Revenue Act of 1926.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are set forth in the Appendix, *infra*, pp. 24–27.

STATEMENT

Petitioners are cotton brokers and members of the New York Cotton Exchange. Prior to March 23, 1934, they were carrying future delivery contracts for 24,100 bales of cotton for the account of one Abney and his associates. On March 23, 1934, Abney requested [1] that the account be transferred to Messrs. Fenner & Beane, who also were cotton brokers and members of the Exchange. (R. 2, 7–8.)

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[1] The complaint alleges (R. 2) and the first affidavit of Collins (Manager of the firm's Commodity Department) avers (R. 7–8) that the customers requested the transfer. The supplemental affidavit of Collins avers that this request followed the firm's request that the account be transferred (R. 9–10).

On that day, petitioners carried out these instructions. They recorded sales of future contracts for 24,100 bales to Fenner & Beane, who also recorded a purchase of a like amount from petitioners, on the ordinary forms supplied by the New York Cotton Exchange Clearing Association (R. 2–3, 15). The transaction was cleared through the Clearing Association (R. 8, 9). No commission was charged the customers (R. 8).

On March 23, 1934, petitioners made oral request of the Clearing Association to exempt the transaction from the tax, on the ground that it represented a change of brokers rather than an actual sale. The request was denied because there was no such precedent under the customary usage of the Clearing Association. (R. 16.) On April 4, 1934, petitioners filed a "monthly stamp tax memorandum" with the Clearing Association, to which were affixed revenue stamps, including those in the amount of $729.40 which represented the transaction now in question (R. 3, 15–16).

On April 5, 1934, a claim for refund of this tax was filed. It was rejected on June 12, 1934 (R. 3–4). This suit was filed to recover $729.40 in taxes paid. Petitioners moved, on the pleadings and affidavits, for summary judgment (R. 6). Respondent filed a cross-motion for summary judgment, annexing additional affidavits (R. 12). The District Court entered judgment dismissing the complaint (R. 26). The Court of Appeals for the Second Circuit affirmed on appeal (R. 34).

SUMMARY OF ARGUMENT

I

The tax provided by Section 800, Sched. A–4, is imposed on the privilege of using the sales mechanism of a commodities exchange and the business purposes of the parties are immaterial. *Nicol* v. *Ames,* 173 U. S. 509.

II

It is equally clear that this transaction was an actual sale. The petitioners in their transactions with the other brokers and with the Clearing House acted as principals. *Clews* v. *Jamieson,* 182 U. S. 461. As such, they were under a duty not only to make delivery of the cotton to their customer but also to make payment to the Clearing House for this cotton. This last liability could not be released except by an actual sale to the substituted brokers.

The transaction is unrelated to the "scratch sale" which is exempted from taxation by Section 800, Sched. A–4, and, in any event, is clearly not within the definition prescribed by the Treasury Regulations. *United States* v. *Uhlmann Grain Co.*, 84 F. (2d) 901 (C. C. A. 7th) was based on a principle which offers some support to the petitioners but was erroneously decided and also involved important considerations not present in this case.

III

The tax in question has for 26 years been construed by the administrative officials, without recorded protests by taxpayers, and with the acquiescence of the Clearing Association, to include transactions of this nature. This administrative and practical history forecloses attack at this date. *Norwegian Nitrogen Co.* v. *United States,* 288 U. S. 294, 315; *Brewster* v. *Gage,* 280 U. S. 327, 336. In addition, the Treasury Regulations, in force for 17 years, clearly exclude this transaction from the exempt classifications. In view of the many reenactments of the Revenue Acts, without change of the taxing section, these regulations have the force of law. *Old Mission Co.* v. *Helvering,* 293 U. S. 289, 294.

ARGUMENT

I

THE BUSINESS PURPOSES OF THE PARTIES ARE IMMATERIAL TO THE TAXABLE CHARACTER OF THIS TRANSACTION

The District Court found it unnecessary to consider[2] what was the substance of this transaction, because it viewed the tax liability under Section 800

[2] The court was of opinion that "actually there was no sale, for the customer was the owner of the cotton before and after the transaction" (R. 25). As is demonstrated below, this is a quite erroneous view of the transaction.

of the 1926 Act as controlled by form (R. 25). The decision, at least as the principle is applied in this case, seems clearly correct.

This Court considered the nature of this tax (under Section 6, Sched. A, of the Act of June 13, 1898, 30 Stat. 448, 458) in *Nicol* v. *Ames,* 173 U. S. 509. It said (p. 519):

> We think the tax is in effect a duty or excise laid upon the privilege, opportunity or facility offered at boards of trade or exchanges for the transaction of the business mentioned in the act. It is not a tax upon the business itself which is so transacted, but it is a duty upon the facilities made use of and actually employed in the transaction of the business, and separate and apart from the business itself.

Since the tax is not laid upon the *business* of selling cotton futures but upon the *privilege of using the sale mechanism of the exchange,* it is wholly immaterial to tax liability whether or not this sale mechanism as used reflects a business sale. If the exchange facilities for the sale of cotton futures were used, the transaction includes every element upon which the tax is predicated. Petitioners, in asking that a further inquiry be made into the underlying substance of the transaction, wholly disregard the nature of this tax.

It is unnecessary to go as far as the District Court decision, or to consider whether the rule of *United States* v. *Isham,* 17 Wall. 496, 506–507, that

substance must be disregarded for form,[3] need be applied here. For the "substance" of this transaction is not the business purposes of the parties but solely their use of the sale mechanism of the exchange.

II

THIS TRANSACTION WAS A SALE OF COTTON FUTURES IN SUBSTANCE AS IN FORM

The Government believes that the taxable character of this transaction is established by the undisputed fact that it involved the use of the sale mechanism of the Exchange. However, it seems equally clear that the transaction was, in actual fact and in legal effect, a sale of cotton futures. The court below based its decision upon this ground (R. 32–34).

Petitioners' argument (Br. 4–6) that the transaction was not a "real sale", but merely the transfer of a brokerage account to another agent cannot properly be evaluated unless the nature of the transactions on the New York Cotton Exchange be analyzed in some detail.

Abney directed petitioners to purchase future contracts calling for May delivery of 24,000 bales of cotton.[4] Petitioners went upon the floor of the

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[3] See *Goodyear Co.* v. *United States*, 273 U. S. 100, 103, limiting this rule to a documentary stamp tax, and compare the approach of this Court in *Provost* v. *United States*, 269 U. S. 443.

[4] For purposes of simplicity, it will be assumed that Abney purchased 24,000 bales of cotton futures at the same time,

Exchange and purchased these contracts from another member, who was, it may be assumed, acting for a customer who wished to sell. The selling broker signed and delivered to petitioners a contract, or "slip", agreeing to deliver 24,000 bales of cotton to petitioners in May, at 11.87 cents per pound. Petitioners in turn signed and delivered to the selling broker a slip recording that they had purchased 24,000 bales of cotton for May delivery at 11.87 cents per pound. (New York Cotton Exchange, By-Laws, Sec. 34; R. 20–21.) At this stage, then, the legal relationships consisted of: (1) an obligation of an unknown seller to deliver 24,000 bales to the selling broker in May;[5] (2) the obligation of the selling broker (a) to deliver 24,000 bales to petitioners in May, and (b) at that time, or possibly at once, to pay the unknown seller approximately $1,500,000; and (3) the obligation of petitioners (a) to pay $1,500,000 to the selling broker when delivery is made to him in May, and (b) to deliver 24,000 bales to Abney in May.

At the close of the day's business, the transactions of petitioners and of the selling broker were cleared through the Clearing House. The clearing is accomplished by purchases by and sales to the Clearing House. If, on this day, petitioners had

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and that they all called for May delivery at 11.87 cents. Compare R. 23.

[5] This obligation was probably cancelled by an earlier obligation of the selling broker to deliver the 24,000 bales to the customer.

engaged in no other transaction, their records sent to the Clearing House would show 24,000 bales purchased. The Clearing House would accordingly agree to sell 24,000 bales to petitioners; this obligation would be covered by a converse obligation from other brokers.[6] New York Cotton Exchange Clearing Association, By-Laws, Sec. 11 (R. 22–23); *Hubbard,* Cotton and the Cotton Market, p. 266, 270; *Hoffman,* Future Trading, p. 202 et seq. Petitioners' status would then consist of a duty to pay the Clearing House $1,500,000[7] when delivery was made by the Clearing House in May, a right to receive from the Clearing House 24,000 bales of cotton in May, and a duty to deliver 24,000 bales of cotton to Abney in May.[8]

At this juncture, Abney requested that the account be transferred to Fenner & Beane. The transaction by which this was accomplished took

[6] Unless the Clearing House were arbitrarily to choose the selling broker or brokers who should assume the duty to make delivery to the brokers whose transactions showed a net purchase, there is no other device by which the transactions could completely and expeditiously be cleared.

[7] This figure is retained without allowance for "marking the contracts"; i. e. for payments to or by the Clearing House representing the difference between the price at which the transaction was made and that at which the market closed. (Clearing Association, By-Laws, Sec. 11; R. 22–23.)

[8] In this discussion no account will be taken of the margin arrangements between the customer, the broker and the Clearing House. They do not change the legal analysis in any particular. For a full description of the margin arrangements, see *Hoffman, supra,* pp. 205–210; *Garside,* Cotton Goes to Market, pp. 141–142.

place as follows: (1) Abney, whose request to transfer the account was made in the light of the Exchange rules (New York Cotton Exchange, Rule 1; cf. R. 8; *Bibb* v. *Allen,* 149 U. S. 481, 489–490), in effect asked petitioners to sell at the price of 11.87 and Fenner & Beane to buy at 11.87. Abney accordingly promised May delivery of 24,000 bales to petitioners, thus off-setting petitioners' earlier obligation to deliver this amount to him in May. Petitioners in return promised to pay $1,500,000 to Abney, as the sale price of this cotton, thus off-setting Abney's earlier promise to pay this amount to petitioners. Accordingly, all obligations between Abney and the petitioners were eliminated. (2) The transaction between the brokers consisted of a sale of 24,000 bales, for May delivery, to Fenner & Beane. Petitioners agreed to deliver 24,000 bales, at 11.87 cents, to Fenner & Beane in May, and Fenner & Beane agreed to pay petitioners $1,500,000 at that time. (3) In the clearing transaction, these duties were assumed by the Clearing House. It promised May delivery of the 24,000 bales to Fenner & Beane, who promised to pay the Clearing House $1,500,000 at that time. (4) Petitioners as a result of this transaction (a) were under obligation to deliver 24,000 bales to the Clearing House in May, and (b) had a right at that time to receive $1,500,000 from the Clearing House. These rights and duties were exactly off-set by the earlier obligations, arising from the

original purchase for Abney, (a) of petitioners to pay the Clearing House $1,500,000 on delivery, and (b) of the Clearing House to deliver 24,000 bales to petitioners in May.

In result, petitioners were entirely released of all rights and duties in connection with the Abney account, and their place was taken by Fenner & Beane who were obligated to make the payment to the Clearing House and to make delivery of the cotton to Abney. The transaction was not a mere formality. It resulted in releasing petitioners of their obligations: (1) to deliver 24,000 bales of cotton to Abney in May, and (2) to pay the Clearing House $1,500,000 when the cotton was delivered to petitioners. Had the transaction been merely the substitution of one agent for another, it would have had the first consequence but could not have released petitioners of their obligation to pay the Clearing House. This was an obligation assumed by petitioners as principals and could be performed only by (1) making payment or (2) obtaining an off-setting obligation from the Clearing House. The latter alternative was achieved by *selling* the cotton futures to Fenner & Beane (and thus to the Clearing House); it could not otherwise have been accomplished.[9]

[9] Section 7 of the Commission Law Rules of the New York Cotton Exchange (R. 22) recognizes that this transaction constitutes a sale. It requires that full commission be charged "for both *buying and selling*" if the transfer is at the request of the customer.

The basic error of petitioners consists of their insistence that they were mere agents, with the status of a broker acting for a disclosed principal (Br. 4–6). It is abundantly plain that this is not the case, and that, in their transactions with other brokers and with the Clearing House, petitioners acted only as principals. New York Cotton Exchange, By-Laws, Sec. 34 (R. 20); New York Cotton Exchange Clearing Association, By-Laws, Sec. 11 (R. 22–23); *Mullinix* v. *Hubbard*, 6 F. (2d) 109, 110 (C. C. A. 8th); *American Cotton Mills* v. *Monier*, 61 F. (2d) 852, 854 (C. C. A. 4th); *Hutton* v. *Terrill*, 255 Fed. 860, 862 (S. D., N. Y.); *Jemison* v. *C. S. Bank*, 122 N. Y. 135, 142; cf. *Clews* v. *Jamieson*, 182 U. S. 461, 482–483; *Wilhite* v. *Houston*, 200 Fed. 390, 392 (C. C. A. 8th); *Garside*, Cotton Goes to Market, p. 138; *Hoffman*, *supra*, pp. 168, 185–186. Having acted as principals, petitioners had incurred liabilities which could not be released if the account were attempted to be transferred by means of a mere transfer of the agents' duties from petitioners to Fenner & Beane. The obligation to pay the Clearing House $1,500,000 could be released only by means of a sale to Fenner & Beane, and thus to the Clearing House.[10] Thus, the sale was not a mere formality but an actual transaction which was indispensable if the parties' purpose were to be accomplished.

[10] Section 800, Sched. 4–A, *infra*, provides that transfers to a clearing-house shall not be taxed, "provided that such transfer shall not vest any beneficial interest in such clear-

In *Provost* v. *United States,* 269 U. S. 443, this Court held that the so-called "loan" of stock, to permit delivery after a short sale, was a "sale" of shares of corporate stock and taxable under Title VIII, Sched. A–4, of the Revenue Act of 1917 (c. 63, 40 Stat. 300, 322). Its statement (p. 454), in regard to the argument that the transaction was essentially the pledge of stock, is equally applicable to petitioners' contentions that this transaction was a mere substitution of agents: "These arguments ignore the essential legal characteristics of the * * * transaction."

Petitioners argue that the transaction was equivalent to a "scratch" or "transferred" sale and that the statutory exemption from taxation of the scratch sale should result in the exemption of this transaction (Br. 12–13). This contention is based upon an erroneous analysis of the nature of the scratch sale and a mistaken view of the reasons which led Congress to exempt this transaction.

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ing-house association but shall be made for the sole purpose of enabling such clearing-house association to adjust and balance the accounts of the members * * *." Congress cannot be supposed by this language to have intended that the rights and duties of the Clearing Association should be treated as merely formal and without substantial content. Since the sales to and by the Clearing House would fail of their purpose unless they invoked all the legal consequences of sale, the qualification as to vesting no beneficial interest must be taken to mean only the requirement that each purchase or sale be off-set by a corresponding sale or purchase to the other broker.

1. The scratch or transferred sale is one which involves a virtually simultaneous off-setting purchase and sale at the same price. It occurs in two situations: (a) The first arises when a broker, in order to fill the exact amount of an order, buys a larger amount and sells to a third broker whose order, combined with that of the original broker, exactly equals the only available offer. For example, broker A may have an order to buy 3,000 bales. Broker B is offering to sell 5,000 bales. Broker A notices that broker C is bidding for 2,000 bales. A therefore buys 5,000 bales from B and, at the same price, sells 2,000 bales to C. He then asks B to deliver to C, and C to accept delivery from B. If they agree, A's name, as to the 2,000 bales, is scratched off the records of B and C which therefore show a sale of 2,000 bales by B to C. (b) The second situation arises from "scalping" transactions which show no profit. The scalper is a trading member of the Exchange who seeks his profit in fractional movements, and necessarily buys and sells with great rapidity. It may often chance that he will buy, say, 1,000 bales and, for one reason or another, will sell it shortly afterward for exactly the price which he paid for it. In such a situation, he will customarily ask the seller to deliver to the subsequent buyer and, if they agree, his name is scratched out of the two transactions. See testimony of James H. Winston, House Committee on Ways and Means, Hearings on Revenue Act of 1918, II, pp. 1214, 1216, 1222.

Prior to the scratching out of the intermediary broker, in either of these transactions, he was liable both to his seller and to his buyer. Accordingly, the transaction would, if it remained in that status, be subject to the tax. But, in consenting to the scratch-out, the other two parties release him from all obligations running to either of them. The net result is that his momentary rights and liabilities have entirely vanished and there remains no change in position upon which to predicate the tax. Such is not the case in the transaction now in question, where the sale of the 24,000 bales resulted in petitioner's release from its obligations (a) to pay the Clearing House, say, $1,500,000 and (b) to deliver 24,000 bales to Abney.

It should be noted that the scratch sale is not reported to or cleared through the Clearing House. (Hearings on Revenue Act of 1918, *supra*, at p. 1215.) This recognition by the Exchange of the absence of any transaction sufficient to change the status of the intermediary broker is to be contrasted with the necessity that the sale by which an account is transferred be cleared through the Clearing House.

2. The exemption given scratch or transfer sales first appeared in Section 1107, Sched. A–5, of the Revenue Act of 1918, c. 18, 40 Stat. 1057. The committee reports [11] contain no explanation of this

[11] H. Rept. No. 767, p. 57; S. Rept. No. 617, p. 18; 65th Cong., 2d Sess.; H. Rept. No. 1037, 65th Cong., 3d Sess.

amendment, but the hearings before the Ways and Means Committee make quite plain that the exemption was granted as a matter of policy, to prevent driving the scalper out of business, as was threatened under the provisions of the 1917 Act (sec. 807, Sched. A–5, c. 63, 40 Stat. 300) which expressly subjected the scratch sale to tax. See the testimony of Winston and the colloquy with committee members, Hearings on Revenue Act of 1918, *supra,* pp. 1212–1223. No such consideration is applicable to the transaction in question.

3. Finally, Articles 44 (a) and 125 (3) (c) of Treasury Regulations 71, *infra,* require, among other things, (a) that the purchase and sale be made on the same day if the scratch sale exemption is to apply, and (b) that the intermediary broker instruct the broker who sold to him to deliver to the broker who bought from the intermediary broker. It is apparent that, even apart from the Regulations, both of these requirements are essential if the transaction is to be a true scratch sale. The transaction now in question meets neither requirement. Articles 44 (a) and 125 (3) (c) are identical with Articles 23 (a) and 33 (3) (c) of Regulations 40, adopted under the 1918 Act. The many reenactments of the taxing section, without relevant change, give the regulations the force of law. *Old Mission Co.* v. *Helvering,* 293 U. S. 289, 294; *Hartley* v. *Commissioner,* 295 U. S. 216, 220.

Petitioners also stress the fact that this transaction did not take place under open bidding on the

Exchange but was arranged by the brokers at the price originally paid by petitioners (Br. 5). But Schedule A–4 of Section 800, in providing that the tax applies to "each sale, agreement of sale, or agreement to sell * * * at, *or under the rules or usages of,* any exchange," expressly includes this situation. Section 7 of the Commission Law Rules of the New York Cotton Exchange (R. 22) governs the sales by which an account is transferred,[12] and thus makes plain that the transaction occurred "under the rules or usages" of the Exchange.

As the court below pointed out (R. 33), the opinions of the witnesses, set forth in petitioners' affidavits, that these transactions were not actual sales (R. 8, 9, 10, 11–12) are mere opinions as to a question of law and are to be given no weight.

The Government can see no support for petitioners' position except that which they derive from *United States* v. *Uhlmann Grain Co.*, 84 F. (2d) 901 (C. C. A. 7th). The case involved taxes imposed, under the section now in question, on a wheat

[12] So far as petitioner's argument (Br. 5) may be based on the failure to charge commissions (R. 8) it should be noted that Section 7 of the Commission Law Rules (R. 22) provides that a commission *must* be charged when the account is transferred at the request of the customer. Since the transaction is precisely the same, irrespective of which party requests the transfer, it is immaterial whether commissions should or should not have been charged in this case. See footnote 1, *supra*, p. 2.

transaction on the Chicago Board of Trade. Under the rules of the clearing house of that exchange, members must post collateral to guarantee performance of contracts under which they undertake to make future delivery; that is, they must post margin for short sales. The margin requirement increases progressively, so the custom has grown up of making "accommodation trades" or "position loans." [13] The member with an excessive short interest delivers his contracts to one whose position is such that he can absorb the additional short interest under lower margin requirements than is required of the transferor. Although the transactions are recorded on different forms than ordinary sales and are not required to be executed in the pit, they appear on the records of the clearing house as ordinary sales. The Court of Appeals held that these "accommodation trades" were not sales, or agreements of sale or to sell under Section 800, Sched. A–4, of the 1926 Act.

The decision is incorrect and, in any event, is not applicable here.

1. The "accommodation trade" would be useless unless it were a genuine sale, passing full legal title. For the Exchange to release the transferor from

[13] By Section 4 (c) of the Commodity Exchange Act of June 15, 1936 (c. 545, 49 Stat. 1491, Pub., No. 675, 74th Cong., 2d Sess.), "accommodation trades" are prohibited.

his margin requirements, it is necessary that he be under no obligation to make delivery of the wheat. This may be accomplished only if the trader who loans his position assumes, in the place of the one who is accommodated, the full duty to make the agreed delivery. This result, under the clearing house mechanism (similar to that of the New York Cotton Exchange), can be obtained only if the trader who loans his position in effect sells to the trader who is accommodated and so, after clearing, is under obligation to the clearing house to make delivery of the wheat; the other party, by purchase of the wheat, has obtained an off-setting duty on the part of the clearing house to make delivery, thus reducing his net position.

It is immaterial that, by private arrangement between the parties, the trader who is accommodated agrees to sell to the other, at the same price, before delivery need actually be made. The transaction carries all the consequences of a sale and, under clearing house rules, has resulted in vendor and vendee rights and duties between the clearing house and the traders. These rights and duties are wholly unaffected by the repurchase agreement of the parties, and serve to make untenable any contention that the transaction amounts merely to something analogous to a loan or pledge.

The decision in the *Uhlmann* case cannot be reconciled with *Provost* v. *United States*, 269 U. S.

443. There, under the analogous corporate transfer tax, this Court held that a so-called "loan" of stock to enable a short seller to make delivery was a sale and subject to tax. The Court emphasized that the transaction had the legal consequences of a sale and rejected the argument that, in practice, the transaction was subsequently off-set by a "return" of the borrowed stock.[14]

2. Even if it were correctly decided, the *Uhlmann* case is inapplicable to a transaction such as that now in question. The court in that case relied chiefly on the consideration that neither trader intended that the one who "loaned his position" should have to fulfill any of the obligations resulting from the transaction. This element is wholly lacking from the present case. The very purpose of the transaction was that petitioners should be released of their obligations and that Fenner & Beane should assume an equivalent duty to Abney and to the Clearing Association.

In summary, the transaction on the New York Cotton Exchange by which an account is transferred from one broker to another is a sale not only in form but also in substance. Every legal conse-

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[14] The Circuit Court of Appeals for the Seventh Circuit stressed that in the accommodation trade the *same* agreement of sale was returned to the trader who was accommodated. This detail is immaterial and cannot serve to convert into a mere pledge a transaction which has all the legal consequences of a sale.

quence of a sale attaches to this transaction. Petitioners' argument that it represents merely the substitution of one agent for another completely disregards the fact that, as between themselves and the Clearing House, the cotton brokers acted as principals. The argument thus seeks to pursuade this Court that both the form and the substance of the transaction should be ignored in order to obtain conformity with a misleading characterization of the transaction.

III

THE LONG-CONTINUED ADMINISTRATIVE AND PRACTICAL CONSTRUCTION OF THE ACT COMPELS AFFIRMANCE OF THE COURT BELOW

The stamp tax upon commodity futures dates back to the Act of June 13, 1898 (sec. 6, Sched. A, c. 448, 30 Stat. 448, 458), which was repealed by the Act of April 12, 1902 (sec. 7, c. 500, 32 Stat. 96, 97). It was reenacted by the Act of October 22, 1914 (sec. 22, Sched. A, c. 331, 38 Stat. 745) and has continued in force since that date. There have, accordingly, been 26 years of administrative and practical construction of this tax.

The Treasury Department has consistently applied the tax to transactions by which an account is transferred to another broker. The Clearing Association of the New York Cotton Exchange has viewed the transaction as taxable; the Secretary

and Treasurer of the Clearing Association stated that "there was no precedent under the customary usages of the Clearing Association" to grant tax-exemption of these transactions (R. 16). This administrative and practical construction, extending over a quarter of a century, should of itself be sufficient to preclude petitioners' contentions. *United States* v. *Moore,* 95 U. S. 760, 763; *Logan* v. *Davis,* 233 U. S. 613, 627; *Brewster* v. *Gage,* 280 U. S. 327, 336; *Fawcus Machine Co.* v. *United States,* 282 U. S. 375; *Interstate Commerce Commission* v. *N. Y., N. H. & H. R. Co.,* 287 U. S. 178; *Norwegian Nitrogen Co.* v. *United States,* 288 U. S. 294, 315.

In addition, Treasury Regulations have been in effect since the 1918 Act which, in defining the exemptions from the tax, make plain that transactions such as this are not exempt. Regulations 40, Arts. 23 (a), 33 (3) (c); Regulations 71, Arts. 44 (a), 125 (3) (c). There have been many reenactments of the revenue acts since the promulgation of Regulations 40, and the failure to change the section imports Congressional approval of the regulation, *Brewster* v. *Gage,* 280 U. S. 327, 337; *McCaughn* v. *Hershey Chocolate Co.,* 283 U. S. 488, 492; *Murphy Oil Co.* v. *Burnet,* 287 U. S. 299, 307, sufficient to give it the force of law, *Old Mission Co.* v. *Helvering,* 293 U. S. 289, 294; *Hartley* v. *Commissioner,* 295 U. S. 216, 220.

CONCLUSION

For the reasons which have been set forth, we respectfully submit that the judgment of the court below should be affirmed.

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DECEMBER, 1936.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 800. On and after the expiration of thirty days after the enactment of this Act there shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in Schedule A of this title, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, by any person who makes, signs, issues, sells, removes, consigns, or ships the same, or for whose use or benefit the same are made, signed, issued, sold, removed, consigned, or shipped, the several taxes specified in such schedule. The taxes imposed by this section shall, in the case of any article upon which a corresponding stamp tax is now imposed by law, be in lieu of such tax. (U. S. C., Title 26, Sec. 900.)

SCHEDULE A.—STAMP TAXES

* * * * *

4. Produce, sales of, on exchange: Upon each sale, agreement of sale, or agreement to sell (not including so-called transferred or scratch sales), any products or merchandise at, or under the rules or usages of, any exchange, or board of trade, or other similar place, for future delivery, for each $100 in value of the merchandise covered by said

sale or agreement of sale or agreement to sell, 1 cent, and for each additional $100 or fractional part thereof in excess of $100, 1 cent: *Provided*, That on every sale or agreement of sale or agreement to sell as aforesaid there shall be made and delivered by the seller to the buyer a bill, memorandum, agreement, or other evidence of such sale, agreement of sale, or agreement to sell, to which there shall be affixed a lawful stamp or stamps in value equal to the amount of the tax on such sale: *Provided further*, That sellers of commodities described herein, having paid the tax provided by this subdivision, may transfer such contracts to a clearing-house corporation or association, and such transfer shall not be deemed to be a sale, or agreement of sale, or an agreement to sell within the provisions of this Act, provided that such transfer shall not vest any beneficial interest in such clearing-house association but shall be made for the sole purpose of enabling such clearing-house association to adjust and balance the accounts of the members of such clearing-house association on their several contracts. Every such bill, memorandum, or other evidence of sale or agreement to sell shall show the date thereof, the name of the seller, the amount of the sale, and the matter or thing to which it refers; and any person liable to pay the tax as herein provided, or anyone who acts in the matter as agent or broker for such person, who makes any such sale or agreement of sale, or agreement to sell, or who, in pursuance of any such sale, agreement of sale, or agreement to sell, delivers any such products or merchandise without a bill, memorandum, or other evidence thereof as herein required, or who delivers such bill, memo-

randum, or other evidence of sale, or agreement to sell, without having the proper stamps affixed thereto, with intent to evade the foregoing provisions, shall be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not exceeding $1,000 or be imprisoned not more than six months, or both.

No bill, memorandum, agreement, or other evidence of such sale, or agreement of sale, or agreement to sell, in case of cash sales of products or merchandise for immediate or prompt delivery which in good faith are actually intended to be delivered shall be subject to this tax.

This subdivision shall not affect but shall be in addition to the provisions of the "United States cotton futures Act," approved August 11, 1916, as amended, and "The Future Trading Act," approved August 24, 1921. (U. S. C., Title 26, Sec. 902.)

Treasury Regulations 71, approved July 16, 1932, promulgated under the Revenue Act of 1926:

ART. 44. *Transactions not subject to tax.*—

(a) So-called "transfer or scratch sales" or "pass-outs" are not subject to the tax: *Provided,* That the purchase and sale are made at the same exchange, on the same day, at the same price, and for the account of the same person.

* * * * *

ART. 125.

* * * * *

(3) As used in Chapter IV of these regulations—

* * * * *

(c) The term "transferred or scratch sale" includes "pass-outs" or those transac-

tions in which a person buys from another a certain quantity of any product at a certain price, and at the same session of an exchange, sells to a third person the same quantity of the same product at the same price, and eliminates himself by instructing the person from whom he bought to deliver such product to the person to whom he sold; but no transaction in which a broker or a commission member of an exchange receives a commission greater than that charged to a person who executes his own contracts shall be deemed to be a "transfer" or a "scratch sale";

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U. S. GOVERNMENT PRINTING OFFICE: 1936

OPINION

SUPREME COURT OF THE UNITED STATES.

No. 332.—October Term, 1936.

Francis I. Dupont, et al., Petitioners, *vs.* The United States of America. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[February 1, 1937.]

Mr. Justice Roberts delivered the opinion of the Court.

Section 800, Schedule A (4) of the Revenue Act, 1926,[1] imposes a stamp tax upon "each sale, agreement of sale, or agreement to sell (not including so-called transferred or scratch sales) . . . at, or under the rules or usages of, any exchange . . . for future delivery." Whether the tax is payable upon a broker's transfer of a customer's account in cotton futures to another broker through the cotton exchange is the matter in controversy. The Circuit Court of Appeals has held the transaction taxable.[2] A conflict of decision moved us to grant certiorari.[3]

Petitioners are members of a partnership trading on the New York Cotton Exchange. On behalf of a customer they purchased cotton for future delivery. They were instructed by the customer to transfer the account to other brokers. To accomplish this petitioners delivered a "sold" memorandum to the transferee of the account, who, in turn, delivered a "bought" memorandum to the petitioners. No commission was charged because the instructions to transfer had been given at petitioners' request, as they desired to be relieved of the account. In order to record such a transfer with the exchange the custom was to use bought and sold memoranda in the form invariably employed by members of the exchange in purchase and sale of cotton for future delivery. The petitioners affixed to the sold memorandum stamps in the proper amount and after denial of a refund, brought action for the amount of the tax.

[1] 26 U. S. C. 903.

[2] 83 F. (2d) 951.

[3] See *United States* v. *Uhlmann Grain Co.*, 84 F. (2d) 901.

The petitioners contend that no sale, agreement of sale or agreement to sell was in fact made, though for convenience, and because of lack of other medium to evidence the transfer, papers in form agreements of sale were employed. The government insists that the tax is essentially upon the privilege of using the facilities of an exchange and petitioners here exercised this privilege and a sale was in fact made. We hold the tax was lawfully imposed and the petitioners are not entitled to recover the value of the stamps.

1. The transaction was not a "scratch" or "transferred" sale within the meaning of the exemption found in the section. A scratch or transferred sale is one in which there is an offsetting purchase and sale at the same price on the same day. Where a broker, in order to fill a customer's order, buys a larger amount and sells the excess to a third broker, directing the selling broker to deliver the excess to the broker who has purchased it, and directing the broker who purchases the excess to take delivery from the selling broker, the name of the intermediate broker is erased from the records of the exchange so that the sale of the excess appears as a sale direct from the one to the other of the two remaining brokers. The exemption also covers trading by a scalping broker who makes his profit in fractional movements on the exchange, buying and selling with great rapidity, thus often purchasing and selling the same amount of the commodity at the same price within a few moments or hours. By agreement amongst the members his name is scratched out of the records of the exchange and his temporary rights and liabilities do not appear upon its records. Accordingly, the Treasury Regulations in force since 1918 require that purchase and sale be consummated on the same day if the exemption is to apply and that the intermediate broker instruct the broker who sold to him to deliver to the other who bought from him.[4]

2. The tax is not upon the business transacted but is an excise upon the privilege, opportunity, or facility offered at exchanges for the transaction of the business. It is an excise upon the facilities used in the transaction of the business separate and apart from the business itself.[5] In this view it is immaterial

[4] Treasury Regulations 40 under R. A. 1918, Articles 23 (a) and 33 (3) (c). Treasury Regulations 71, Articles 44 (a) and 125 (3) (c).

[5] *Nicol* v. *Ames*, 173 U. S. 509, 519, 523.

whether the transfer of the account constituted a sale. Unquestionably the petitioners used the facilities of the exchange for offsetting their obligation as a purchasing broker by arranging that another broker should take over that obligation under the rules of the exchange. Such a transaction comes within the intent of the statute and renders petitioners liable for the tax.

3. Under the rules and practice of the Cotton Exchange the transaction taxed was an actual sale. The fact that the sale was made for the purpose of transferring a brokerage account is irrelevant. When the petitioners purchased on the exchange the future contracts for their customer the selling broker handed the petitioners a memorandum agreeing to deliver at the date and price therein specified and the petitioners gave the selling broker a similar purchase memorandum. This each was required to do by the by-laws of the exchange. As a result of the operations of the clearing house the petitioners would, at the close of the day's business, be under obligation to pay the clearing house upon delivery being made at the future date and they would have a correlative right to receive from the clearing house the cotton purchased. Although the broker who made the sale to the petitioners would have a right to receive from his principal the necessary cotton to make delivery according to the sale, and although the petitioners who had bought the cotton would be under an obligation to their customer to deliver to him, both brokers were, under the by-laws of the exchange, principals in the transaction. When, therefore, the customer ordered the transfer of the account the petitioners could only effect this by selling the futures to the substituted broker who, in turn, became obligated, so far as the exchange was concerned, as principal, to accept delivery of the cotton according to his purchase from the petitioners. The obligation assumed by the petitioners when they entered into purchase contracts could be satisfied by making payment to the clearing house or offset by selling to another broker and so obtaining that broker's contract to take delivery of the cotton from the clearing house. In no other way could the petitioners relieve themselves of that obligation.

The judgment is

Affirmed.